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SUBJECT: BOLIVIA'S 2006 BUDGET: STRONG STATE PRESENCE

¶1. Summary: The Morales administration sent a revised 2006 public budget proposal to Congress on March 24. The revised budget includes additional appropriations for health and education, while cutting salaries for government workers. Although the new administration has not yet released its economic plan, the proposed budget sends a clear signal that the GOB will emphasize social spending and public investment. Overall budget figures are the same as the previous 2006 budget submitted during the last quarter of 2005, including a predicted 4.1 percent deficit. However, Finance Ministry contacts informed us that the GOB has several other spending proposals in the hopper that could more than double the current projected deficit. End Summary.

GOB SUBMITS REVISED BUDGET TO CONGRESS

¶2. On March 24, 2006, the new administration submitted a revised 2006 budget to congress. The proposed budget contains no significant overall revenue and expenditure changes, but shifts funds among sectors. Announced government worker salary cuts will become effective at the end of April, and the savings will be reallocated to finance a seven percent raise for health and education workers.

PRINCIPAL ECONOMIC GROWTH AND CURRENCY ASSUMPTIONS

¶3. The 2006 public budget is based on several questionable assumptions about the GOB's still undefined macroeconomic policy. The new administration assumes an economic growth rate of 4.1 percent and an inflation rate of 3.4 percent for ¶2006. The boliviano is expected to devalue at a slower rate than in previous years; the budget projections assume an average exchange rate of 8.12 bolivianos per US dollar. The GOB is also expecting a 3 to 5 percent efficiency increase in tax and customs collections, a possibility if institutional reforms in the tax service are carried out.

BUDGET BREAKDOWN

¶4. The expenditures budget for 2006 is USD 4.2 billion,

equal to about 40 percent of the projected nominal GDP of USD 10.6 billion. Revenues are expected to total 3.8 billion, or 36 percent of projected GDP. Of this aggregate amount, royalty and tax revenues represent 63 percent, which demonstrates the GOB's increasing reliance on tax collection, particularly from the hydrocarbons industry, vice other forms of revenue.

¶15. The largest items in the budget are government salaries

and procurement of goods and services, which make up 62 percent of total current expenditures and 49 percent of the total expenditure budget, which is comprised of current and capital expenditures. Also notable is approximately USD 410 million of payments for pensions and USD 756 million for public investment. Domestic and foreign public debt service payments are expected to total USD 320 million in 2006.

FISCAL DEFICIT PROJECTIONS

¶16. The 2006 fiscal deficit is expected to be around USD 440 million, which by our calculations reaches 4.1 percent of projected GDP. However, according to the draft budget, the deficit is projected to be 3.7 percent of GDP. In either case, the anticipated deficit for 2006 is lower than previous projections for this year, despite additional expenses arising from MAS campaign promises. However, several possible expenses, such as those resulting from a promised minimum wage increase, have not been included in the budget because they have not yet been approved. Unofficial estimates for such additional expenses reach 3 to 4 billion bolivianos (USD 375 to 500 million). These additional expenses would more than double the GOB's projected fiscal deficit.

¶17. While the overall deficit is expected to reach USD 440 million in 2006, the Bolivian Treasury anticipates a gap of USD 500 million, partially due to insufficient cash flow from regional government accounts to central government balance sheets. This gap will likely be covered by Central Bank loans.

¶18. The Bolivian fiscal deficit will be financed from external and domestic sources. For 2006, Bolivia has received external funding commitments from the World Bank, the Inter-American Development Bank, the Andean Development Corporation, the Agriculture Development Fund, Korea, Brazil, Spain, France, Italy, China, and Germany. Internal funds will be provided by the domestic Administration Pension Funds. For 2006, the administration plans to fund approximately 55 percent of the deficit, or USD 240 million, from external sources and 45 percent, or USD 200 million, from domestic sources. Total public debt service payments are expected to account for 8 percent of government expenditures, which comes to USD 320 million.

PUBLIC INVESTMENT

¶19. The GOB's fiscal policy aims to stimulate the economy by increasing public investment. Total public investment is projected to be approximately USD 760 million for the year (or 7 percent of GDP), which represents an 18 percent increase from the previous year's budgeted investment. The majority of these funds will be transferred to regional and municipal governments, with the departments of Santa Cruz, Tarija, La Paz, and Cochabamba receiving two-thirds of the USD 760 million. Eighty-two percent of the public investment budget is earmarked for infrastructure and social projects.

COMMENT: POLITICAL PROMISES MIGHT TRIGGER FISCAL DEFICITS

¶10. Extraordinary revenues from special taxes and donations helped the GOB attain a record low fiscal deficit of two percent in 2005. As these revenues and donations may decline this year and the GOB's "safety net" relationship with the IMF ended in March 2006, fiscal restraint will be crucial to ensuring a continued low deficit. However, the

GOB is likely to increase spending, particularly for public investment, in order to strengthen the role of the state in the economy, stimulate employment, and maintain its popularity. Increased spending could buoy support for the administration, but could backfire if it reaches the point of undermining macroeconomic stability. End comment.

BREAKDOWN: BUDGET 2006
(Millions of USD)

REVENUES	3,765
Current Revenues	3,545
Operating Revenues	611
Tax Revenues	2,135
Royalties	267
Donations	53
Other Revenues	478
Capital Revenues	220
EXPENDITURES	4,206
Current Expenditures	3,316
Salaries	994
Proc. Goods and Services	1,052
Foreign Debt Service	300
Total public transfers	500
Other current expenditures	468
Capital Expenditures	890
OVERALL PUBLIC DEFICIT	440
FINANCING	440
Domestic	202
Foreign	238

Source: Ministry of Hacienda. Public Budget 2006

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